BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS ON

In the Matter of	)	
D. H. W.	)	OAH No. 07-0721-PER
_____	)	Div. R&B No. 2007-036

DECISION

I. Introduction

This is D. H. W.'s second appeal contesting the method the Division of Retirement and Benefits used to calculate his occupational disability benefits as a member of the Public Employees' Retirement System (PERS). In the prior appeal (OAH No. 06-0178-PER), Mr. W.'s proposed method was rejected as contrary to the applicable statute, AS 39.35.410(d), but the matter was remanded to the division for consideration of other calculation methods.[1] On remand, the division concluded that its "original calculation method … is appropriate and that no change [to Mr. W.'s benefit] is warranted."[2] This is Mr. W.'s appeal of the division's decision on remand.

Mr. W. wants the division to use a different look-back period to determine his "gross monthly compensation," including how much overtime he likely would have earned if not for his disability, to calculate his disability benefit. The division concluded that doing so would be inconsistent with how it has administered benefits to other members and that such inconsistencies could jeopardize the favorable tax status of the retirement plan. Because the division's decision is reasonable, and (as ruled in the prior appeal) the method it used to calculate Mr. W.'s benefit is permissible under the statute, the decision is affirmed. The division is not required to use a different method to calculate the disability benefit paid to Mr. W.

II. Facts[3]

On November 16, 2004, while employed by the Department of Corrections, Mr. W. suffered an on-the-job injury. He continued to work until he underwent surgery. As a result of the injury, he was unable to perform the essential duties of his position beginning January 11, 2005. He received worker's compensation benefits for temporary total disability effective

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[1] March 9, 2007 Decision at 9-11 (rejecting Mr. W.'s method as "contrary to the plain language of AS 39.35.410(d)…" and remanding for reconsideration of other methods not inconsistent with the statute). The March 9, 2007 decision is incorporated into this decision and is attached as Appendix A.

[2] October 26, 2007 Letter from Shier to W. at 1, Agency Rec. 2.

[3] *See generally* Appendix A at 1-3 & 4. Unless the context or a citation indicates otherwise, the material facts are taken from the March 9, 2007 decision in the prior appeal. With consent of the parties, the record for the prior appeal was made part of the record for this appeal. *See* January 17, 2008 Recording of Prehearing Conference.

January 11, 2005, and was placed on unpaid leave under provisions of the Family and Medical Leave Act.

During the time Mr. W. was on leave, his position was reclassified from a 42-hour work week (which he usually worked an 84 hours per week, week on-week off schedule[4]) to a 40-hour work week. On March 17, 2005, Mr. W.'s physician notified the department that Mr. W. could return to work with limited duties. The department advised Mr. W. that upon release by his physician, he would be returned to work on a temporary basis, with a 40-hour work week schedule and restricted duties. Mr. W. received a lump sum worker's compensation benefit for permanent partial disability. He returned to work on March 29, 2005, but with restricted duties and no overtime.

On June 1, 2005, Mr. W.'s physician advised the department that Mr. W.'s condition would not improve, and that he was permanently unable to perform the essential duties of his position. The department investigated the possibility of accommodating Mr. W.'s disability pursuant to the Americans with Disabilities Act but determined that no reasonable accommodation was possible, and that no vacant positions were available that Mr. W. could fill. As a result of his disability, Mr. W. was separated from service on September 30, 2005, after working for the state about 17 years.[5]

Mr. W. had been unable to work for about two months during the twelve month period immediately preceding his separation from service because he was recuperating from surgery necessitated by his on-the-job injury. After he returned to work, he was placed in the reclassified, 40-hour-per-week position that did not include regularly scheduled overtime, and he was not given overtime work because of his physical condition. Mr. W.'s overtime compensation during the period that the division used to calculate his benefit was lower than his overtime compensation during the twelve month periods immediately preceding (1) his on-the-job injury and (2) the date he last worked in his regular capacity.

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[4] February 6, 2008 Recording of Oral Argument by D. W. (explaining his pre-injury work schedule while indicating that the issues his appeal raises concern not just the look-back period for purposes of overtime but also the difference between a 42 and 40 hour work week in determining gross monthly compensation).

[5] *See* December 6, 2005 Administrator's Statement for Disability Benefits, Agency Rec. at 71 (estimating years of credited PERS service as of September 30, 2005 termination at 17.35891); *also* Member Historical Event Date Display for D. H. W., Jr., Agency Rec. at 63 (listing date of hire as 05/23/1988); February 6, 2008 Recording of Oral Argument by D. W. (stating, in the context of questioning which version of the statute applies, that he had worked for the state 17 years).

Mr. W. was placed on disability status effective October 1, 2005. The division calculated his disability benefit based on his hourly wage at the time he was terminated and his overtime compensation over the twelve-month period immediately prior to that date. In the prior appeal, Mr. W. contended that rather than using the twelve months ending September 30, 2005, to calculate his compensation, the division should have used the twelve months ending on the date he last worked in his regular, unrestricted capacity. The decision in the prior appeal concluded that the date Mr. W.'s employment terminated, not an earlier date such as the day before his injury, controls which period must be used.[6]

The decision in the prior appeal also concluded that the division could consider other calculation methods, "at least with respect to the calculation of overtime compensation," but that the method the division used was "reasonable and within the scope of permissible interpretations of AS 39.35.410(d)."[7] Mr. W.'s case was remanded to the division with instructions that the division reconsider it in light of that decision and that Mr. W. would have the right to appeal the division's actions on remand if dissatisfied with them.[8] He was dissatisfied that the division's decision on remand was not to change the method of calculation and this appeal followed.

III. Discussion

As in his prior appeal, Mr. W. argues that calculating his disability benefit using the twelve months immediately preceding his termination, during which he was scheduled to work two fewer hours per week compared to his pre-injury schedule and was given little overtime, is not a fair reflection of the compensation he would have been receiving but for the work-related injury. The main issue he raises is the same: whether the division can and must use a different method of calculating his gross monthly compensation—one that sweeps in the higher earnings from overtime and a 42-hour work week he earned prior to his injury. The decision in the prior appeal answered the first part of the issue by concluding that using some other methods would be permissible under AS 39.35.410(d). This decision will not revisit that conclusion.

New to Mr. W.'s current appeal is the question: does the division's reason for using the same twelve-month look-back period when calculating disability benefits for all PERS members justify its decision not to use a different method for Mr. W. and similarly situated PERS

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[6] March 9, 2007 Decision at 4-5 (holding that AS 39.35.410(d) should be interpreted consistently with how the Alaska Supreme Court had interpreted subsection (a) of the same statute).

[7] *Id*. at 8.

[8] *Id*. at 11.

members? Before reaching that question, it is necessary to address Mr. W.'s concern about which version of the applicable statute applies.

A. THE CURRENT VERSION OF AS 39.35.410(d) APPLIES.

Near the end of oral argument, Mr. W. read from a 1999 Internal Revenue Service (IRS) document which, in part, recounts the history of Alaska's PERS statutory changes concerning disability benefits.[9] Among other things, the IRS document observes that different versions of the PERS statutes may apply to members based on when the members were first hired and cites *Hammond v. Hoffbeck*, 627 P.2d 1052 (Alaska 1981). In the *Hammond* case the Alaska Supreme Court held that "the right to [PERS] benefits vests immediately upon an employee's enrollment in [PERS]."[10] Using the IRS document as a touchstone for his argument, Mr. W. questioned whether the division might have applied an incorrect version of the disability benefits statute to him.

Subsection (d) of AS 39.35.410 was last amended in 1986, when the word "benefit" was substituted for the word "pension."[11] Later changes to AS 39.35.410 have affected or added subsections other than (d).[12] Since 1986, AS 39.35.410(d) has read as follows:

> The monthly amount of an occupational disability benefit is 40 percent of the disabled employee's gross monthly compensation at the time of termination due to disability.

Mr. W. was hired in 1988. The current version of section 410(d), therefore, is the version applicable to his disability benefit calculation.[13]

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[9] February 6, 2008 Recording of Oral Argument by D. W. (reading from October 15, 1999 Letter from Olmstead (IRS) to Walkush (division) which, beginning on page 11, discusses Olmstead's understanding of the changes in Alaska's statutes pertaining to disability benefits). The letter is included in the record as Attachment A to the division's February 5, 2008 Notice of Supplementation of Record.

[10] *Hammond*, 627 P.2d at 1057.

[11] 1986 Sess. Laws of Alaska, ch. 82, § 36.

[12] *See* 2000 Sess. Laws of Alaska, ch. 68, § 42 (amending subsec. (f)); 2002 Sess. Laws of Alaska, ch. 59, § 38 (adding subsecs. (i) & (j)); 2005 Sess. Laws of Alaska, First Special Session, ch. 9, § 111 (amending subs. (f)).

[13] In questioning which version of the statute applies, Mr. W. did not explicitly assert that he has a "vested right" in use of whatever calculation method the division was applying to disability benefits at the time he was hired. An unconstitutional diminution of a PERS member's "vested rights" could occur or could be avoided, not just through a specific statutory change, but also through the manner in which the statutes are implemented. *See Sheffield v. Alaska Public Employees' Ass'n*, 732 P.2d 1083, 1089 (Alaska 1987) (concluding that a diminution of benefits can arise from regulations prescribing actuarial factors); *Alford v. State*, Slip Op. 6315 at 9-12 (Alaska Oct. 16, 2008) (discussing constitutional prohibition against diminution of benefits and illustrating that offsetting advantages through which an unconstitutional diminution can be avoided need not be statutory). If Mr. W.'s intent was to make such an argument, that intent was not clear. He did not argue that a method in use when he was hired should have been applied to calculation of his benefits. Thus, even if he was attempting to raise a vested rights argument, he did not meet his burden of proving that he had a vested right to have his disability benefits calculated based on a method dating to his 1988 hire.

B. THE DIVISION'S DECISION IS REASONABLE.

After the remand, the division's decision remained unchanged but the reasoning focused on the need to consistently administer the PERS plan.[14] The division's concern that lack of consistent administration might jeopardize the favorable tax treatment PERS members enjoy was raised in the prior appeal but not addressed in much detail in the decision remanding the matter to the division.[15] That decision suggested that the division is permitted under AS 39.35.410(d) to devise different calculations methods, one for each group of similarly situated members, and might be able to do so without running afoul of the federal laws controlling the tax status of retirement benefits. The division chose instead to stick with a single method. Whether the division's persistence is reasonable depends on its statutory obligations taken together, not just on what AS 39.35.410(d) standing alone might permit.

The retirement plan that includes the AS 39.35.410(d) disability benefits "is intended to qualify under 26 U.S.C. 401(a) and 414(d) (Internal Revenue Code) as a qualified retirement plan …."[16] A qualified plan brings to its members favorable tax treatment. For member receiving occupational disability benefits, for instance, the benefit payments are excluded from gross income for purposes of determining the amount of federal income tax the member must pay.[17]

To become and remain a qualified retirement plan, the plan must be set up and administered to comply with certain federal requirements. For a defined benefits plan such as the PERS plan of which Mr. W. is a member, one such requirement is that benefits be definitely determinable.[18] At least as to benefits based on actuarial assumptions—e.g., normal retirement

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[14] *Compare* October 26, 2007 Letter from Shier to W., Agency Rec. 2 (stating that the method used to calculate Mr. W.'s benefit "is the method that is consistently applied to all occupational disability benefit recipients) *with* February 2, 2006 Letter from Millhorn to W., OAH No. 06-0178-PER Rec. 3 (discussing the statutory language and standard operating procedure when explaining why the division was denying Mr. W.'s request that his benefit be calculated based on his pre-injury income) and January 24, 2006 Letter from Davis to W., OAH No. 06-0178-PER, Agency Rec. 7 (emphasizing the statutory language and quoting the standard operating procedure).

[15] *See* Appendix A at 10 (limiting discussion of the division's compliance-with-federal-tax-law argument to a paragraph about the division's "supplemental decision" without analyzing the applicable legal authorities).

[16] AS 39.35.115(b).

[17] 26 U.S.C. § 104(a)(1) (excluding from gross income amounts received under workers' compensation); 26 C.F.R. § 1.104-1(b) (extending workers' compensation-related exclusion to "exclude[] from gross income amounts which are received by an employee … under a statute in the nature of a workmen's compensation act which provides compensation to employees for personal injuries or sicknesses incurred in the court of employment"); October 15, 1999 Letter from Olmstead (IRS) to Walkush (division) at 7-13 (discussing application of gross income exclusion to disability benefits when calculation method makes the benefits more like workers' compensation than normal retirement—e.g., is not based on credited years of service and age of member).

[18] 26 C.F.R. § 1.401-1(b)(1)(i), which states in pertinent part:

> A pension plan within the meaning of section 401(a) [of 26 U.S.C.] is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life,

pension payments—federal statutory law precludes the use of employer discretion to vary the benefits.[19] The IRS has ruled that the requirement for definitely determinable benefits is "satisfied where the benefits for each participant can be computed in accordance with an express formula contained in the plan."[20]

Whether the definitely-determinable-benefits requirement and related IRS rulings to the effect that non-discretionary formulas must be used also apply to ancillary benefits such as disability benefits is not entirely clear. None of the authorities cited by the division, or identified through independent research, spoke directly to whether disability benefits must be definitely determinable. The treatise excerpt on which the division relied as further support of its position that benefits "must be applied consistently and uniformly" speaks not of the requirement for definitely determinable benefits but rather of another requirement for a qualified plan: non-discrimination.[21]

The non-discrimination requirement, in effect, prevents retirement plans from discriminating in favor of highly compensated employees.[22] The amount of benefits received by a member can differ from the amount received by another member without violating the non-discrimination requirement if the benefits "bear a uniform relationship to the compensation" the member received.[23] This is why a correctional officer such as Mr. W. can receive a higher benefit amount than a similarly situated PERS member whose compensation was less during the relevant period without jeopardizing the Alaska PERS plan's qualification. To satisfy the

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> after retirement. Retirement benefits generally are measured by, and based on, such factors as years of service and compensation received by the employees…. Benefits are not definitely determinable if funds arising from forfeitures on termination of service, or other reason, may be used to provide increased benefits for the remaining participants …. A plan designed to provide benefits for employees or their beneficiaries to be paid upon retirement or over a period of years after retirement will, for the purposes of section 401(a) [of 26 U.S.C.], be considered a pension plan if the employer contributions under the plan can be determined actuarially on the basis of definitely determinable benefits…. A pension plan may provide for the payment of a pension due to disability and may also provide for the payment of incidental death benefits through insurance or otherwise….

[19] *See* 26 U.S.C. § 401(a)(25), which states:

> A defined benefit plan shall not be treated as providing definitely determinable benefits unless, whenever the amount of any benefit is to be determined on the basis of actuarial assumptions, such assumptions are specified in the plan in a way which precludes employer discretion.

[20] IRS Revenue Ruling 74-385, found at pages 9-10 of Attachment B to the Division's February 5, 2008 Notice of Supplementation of Record.

[21] *See generally* Excerpt from Chapter 4 of a treatise, included as Attachment C to the Division's February 5, 2008 Notice of Supplementation of Record, cited and discussed at page 2 of the division's notice.

[22] 26 U.S.C. § 401(a)(4).

[23] 26 U.S.C. § 401(a)(5)(B).

uniform-relationship-to-compensation requirement, AS 39.35.410(d) sets all members' disability benefits at a uniform 40 percent of gross monthly compensation. Whether the required uniformity is undermined by use of multiple methods to determine members' "gross monthly compensation" probably depends on the methods themselves. If a single method is used for all members, the plan's compliance with the uniform-relationship-to-compensation requirement could not fairly be challenged.

The division's reason for using a single method to calculate disability benefits finds support in the federal requirements for a qualified plan. The division determined that the method of calculating disability benefits, not just normal retirement benefits, must be applied consistently and uniformly. Though it is arguable whether the definitely-determinable-benefits requirement applies to ancillary benefits such as disability, that requirement and the non-discrimination requirement, taken together, are sufficient to give the division pause when asked, as it has been here, to differentiate between members in the same general category—i.e., eligible for disability benefits—based on how the disabling injury or illness affected their work schedule and earnings immediately preceding termination.

In sum, irrespective of whether the federal requirements actually compel the division to use a single method for calculating disability benefits, it is not unreasonable for the division to choose to do so, particularly when jeopardizing the PERS plan's status as a qualified plan puts at risk the favorable tax treatment Mr. W. and other members enjoy. The division's decision not to apply a different method to calculate Mr. W.'s disability benefit, therefore, is reasonable even if not strictly required.

IV. Conclusion

The current version of AS 39.35.410(d) governs calculation of Mr. W.'s disability benefit. As ruled in the prior appeal, that statute precludes application of Mr. W.'s preferred calculation method. The division's decision following remand to use a singled method for Mr. W. and all other members is reasonable, especially in light of the division's responsibility to preserve the PERS plan as a qualified plan under the United States tax laws. The Division of Retirement and Benefits' decision, therefore, is affirmed.

DATED this 29th day of October, 2008.

By: *Signed*
Terry L. Thurbon
Chief Administrative Law Judge

Adoption

I have considered the November 19, 2008 proposal for action filed by D. H. W. Mr. W. is not correct in his assertion that the decision in the previous appeal concluded that "there is a better appropriate methodology…" than that used by the Division of Retirement and Benefits. The decision in that earlier appeal instead concluded that the division could use other methodologies consistent with the statute. The Decision in this, Mr. W.'s appeal following remand, concludes that the division's decision to use a single method is reasonable.

The undersigned, in accordance with AS 44.64.060, adopts this Decision as the final administrative determination in this matter. Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska R. App. P. 602(a)(2) within 30 days after the date of this decision.

DATED this 1st day of December, 2008.

By: *Signed*
Terry L. Thurbon
Chief Administrative Law Judge

See OAH Decision PER060178 for Appendix A.
[This document has been modified to conform to technical standards for publication.]